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# Corporate Governance and Macroeconomics on The Financial Stability of Islamic Banks

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## ABSTRACT

**Purpose:** This study discusses the influence of Corporate Governance and macroeconomics on financial stability in the Islamic banking sector.

**Design/methodology/approach:** This study employed a quantitative and Data analysis uses panel data regression.

**Findings:** while the independent variable in this study is Corporate Governance and Macroeconomics, with the results showing that Corporate Governance and macroeconomics have no partial effect..

**Research limitations/implications:** There are only two variables considered in this paper: corporate governance and macroeconomic.

**Practical implications:** partially corporate governance has no effect and macroeconomics has a negative effect.

**Originality/value:** This study calculates and finds out the truth of corporate governance and macroeconomic variables on financial stability.

**Paper type:** Research Paper

**Keywords:** Corporate Governance, Macroeconomics, Financial Stability, Inflation

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## I. INTRODUCTION

Islamic banks have developed from time to time, starting from the establishment of Bank Muamalat Indonesia in 1991 until now in 2020 there are 14 Islamic banks in Indonesia and 11 in 2021 due to the merger of 3 Islamic banks into Indonesian Islamic Banks.

Economic growth in a country must have good financial stability because it has a positive relationship between financial stability and the level of economic growth. To improve financial stability, it is necessary to look at the influencing factors, including corporate governance and macroeconomic factors

Bank Indonesia, (2006) Corporate governance is governance or a real conception formed with provisions that are in accordance with the norms and rules established by authority institutions and adapted to the circumstances of the institution that has the task of producing goals. As for the implementation of Good Corporate Governance there are five basic principles, namely:

1. Transparency, the openness of presenting relevant information and the openness of the decision-making process.
2. Accountability (accountability) clarity of function and implementation of the accountability of bank organs so that bank operations are effective.

3. Accountability (responsibility) compliance with bank governance with applicable laws and regulations in accordance with healthy bank governance
4. Professional (professional) competence possessed to act objectively without any influence/pressure from any party as well as a commitment to develop Islamic banks.
5. Fairness is fairness in responding to the rights of interest owners based on the applicable agreement  
Macroeconomics is a factor with a broad scope to assess the level of financial stability of Islamic banks, macroeconomics can be calculated by using inflation rates and bank interest rates.

On research (Abuzayed et al., 2018) bank diversification strategy and its relation to financial sector stability. And found that factors such as improved institutional quality, macroeconomic conditions, and other bank-specific factors led to greater stability.

(Lassoued, 2018) The dimensions of corporate governance in this study include the size of the sharia board in addition to the size of the board members and the proportion of independent directors on the board. The study found that the percentage of independent members on the board of directors has a significant positive effect on the financial stability of IBs. However, the Sharia Board and the size of the board are known to have no effect on financial stability.

Based on the above background, the author wants to discuss the magnitude of the influence of corporate governance and macroeconomics on the financial stability of Islamic banks

#### Formulation of the problem

1. Does Corporate Governance affect the stability of Islamic banks' financial performance?
2. Does Macroeconomics affect the stability of Islamic banks' financial performance?

#### Research purposes

1. To determine the effect of Corporate Governance on the stability of the financial performance of Islamic banks
2. To determine the effect of macroeconomics on the stability of the financial performance of Islamic banks

Financial stability is a description of whether or not a financial performance in an organization is good, so that the operations of an organization can run well.

Editors & Molyneux, (2011) That market power can have a beneficial effect on financial stability, because the extraordinary gains associated with a lack of competition increase the value of banks, thereby reducing incentives to invest in riskier activities.

Berger & Bouwman, (2009) show that growing market power leads to greater financial stability, which means that evidence offers supporting the traditional view that excessive banking competition can be detrimental to financial stability.

IAI (2016) Financial Performance, namely the organization's ability to manage financial reports and control its resources.

Mukhibad et al., (2019) Financial performance is an indicator of efficiency in the banking industry.

Gadanecz & Jayaram (2009) Financial stability is a condition in which the financial system consisting of financial institutions, financial markets and financial infrastructure is able to withstand stress, so that the financial intermediation process is not disrupted. The composite quantitative measure of financial system stability can indicate conditions intuitively because it can enable policy makers and system participants to: (a) better monitor the level of financial stability of the system, (b) anticipate the sources and causes of financial stress on the system and (c) communicate more effectively the impact of such conditions

In measuring financial stability, the focus is on the real sector, namely GDP growth, the government's fiscal position and inflation. Second, the risk of the corporate sector. Third, the health of the household sector. Fourth, conditions in the external sector, Fifth, the financial sector is characterized by monetary aggregates, real interest rates, risk measuring the banking sector, bank capital and liquidity ratios, and lastly, the relevant variables to describe financial market conditions are equity index, company spread, premium liquidity and volatility.

(Ghayad, 2008) that the corporate governance of Islamic banks poses an important constraint on the operations of Islamic banks. In addition, the directors of Islamic banks are subject to the governorship granted by the board of directors and the Shariah board and research results that in practice, members of the Shariah Board must have a position to give credibility to the bank as well as its stakeholders and depositors.

IFSB (2009) Governance in Islamic banks includes the Board of Commissioners and the Sharia Supervisory Board, Internal Auditors and the Sharia Internal External Review Unit, using the concept of sharia bank governance in Indonesia based on corporate governance in general by using the principles of sharia compliance as a whole in accordance with provisions that apply in company operations

Aebi et al., (2012) Standard corporate governance is largely insignificant or even negatively related to bank performance during the crisis and Pathan & Faff, (2013) The size of the board of directors and

independent directors reduces bank performance. And Mollah & Zaman, (2015) focus on the role of (i) Sharia Supervisory Board, (ii) board structure and (iii) CEO power in influencing bank performance with the results of DPS research having a significant positive effect on Islamic bank performance, Board structure generally has a positive relationship, while CEO power has negative relationship, although not significant with performance.

Corporate governance is governance that is conceptualized in real terms with provisions made by authority institutions, with ethical development to be carried out in a disciplined manner, GCG can be applied to Islamic banking to increase the trust of users and shareholders through the following objectives: 1) Contribute to welfare efficiently and effectively to shareholders, employees and stakeholders as a solution in dealing with organizational problems; 2) Improving the management of companies that are managed fairly for the benefit of the community, open to information, and can be accounted for; 3) Maintain rights and obligations and recognize them for the stakeholders; 4) Approach based on democracy, and the management and participation of the organization are legitimately adjusted; 5) Controlling conflicts of interest that may arise between the principal and the agent; 6) Provide opportunities for capital providers. And improve the company's financial performance. Thus, Islamic banks give confidence to the public to be able to invest with the aim of developing the company by paying attention to the system of transparency, purification, sharia audits, and external audits of internal control, risk management, accounting systems,

Many researches on macroeconomic factors have been carried out, both related to banking performance and banking conditions. Macroeconomics has an impact on banking financial performance with the level of economic growth. The cause of this impact is because good economic growth will improve the economy of the people in the country.

Varlamova & Larionova, (2014) with research results the better the economic growth in a country, the better the banking sector in collecting and distributing funds through the community. Zarrouk et al., (2016) in their research show that the performance of conventional banks is getting better, if the conditions for increasing a country's economic growth are in good condition. On the concept of Islamic banking, Alqahtani et al., (2017) explains that Islamic banks have good performance, despite the world economic shocks in 1998-2012. This condition can be seen from the profit level of Islamic banking which is better in line with the condition of Gross Domestic Product (GDP) and oil prices that continue to experience ups and downs. (Alqahtani et al., 2017)

The influence of economic factors in different geographical scopes also has a significant impact on the Return on Assets (ROA) of Islamic banking in several regions of the world. This is related to the macroeconomic conditions experienced by countries that have a banking sector, especially Islamic banking. inflation has a significant influence on banking performance. (Masood & Ashraf, 2012)

Zarrouk et al., (2016) stated that inflation affects the operational costs incurred by banks. The higher the inflation rate, the greater the operational costs that will be incurred by banks. Furthermore, in a business competition, two banking systems, namely Islamic banks and conventional banks, are also interesting to study more deeply where banking products are related to the influence of macroeconomic factors (Meslier-Crouzille et al., 2016). The results of the study that there is a comparison between the performance of Islamic and conventional banking explains that Islamic banking in general has a recovery process compared to conventional banks when facing the world economic crisis (Olson & Zoubi, 2017).

In another study said that there was no significant difference in influence between Islamic and conventional banking in the 2007-2008 crisis (Bourkhis & Nabi, 2013). Macroeconomic factors affect the financial performance of banks, conventional banks have the same factors as GDP and interest rates (Rashid & Jabeen, 2016). Based on the data above, the theory is good to study and develop the vulnerability of banks that perform dual banking systems in conducting business activities.

#### Objectives

This study uses a 8 Islamic Commercial Bank

#### Hypotheses

The framework for this research is as follows:

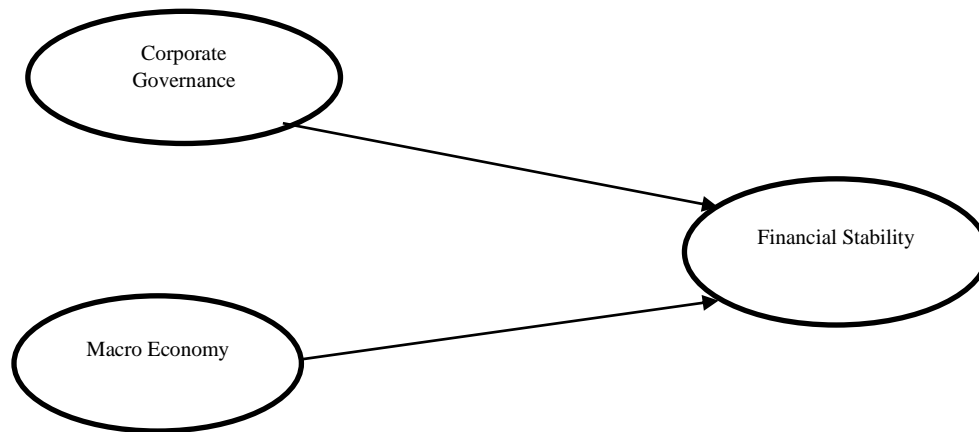


Figure 1. Thinking Framework

Based on the literature above, the hypothesis is as follows:

H1. Corporate Governance affects the financial stability of Islamic banks

H2. Macroeconomics affects the financial stability of Islamic banks.

## II. METHODOLOGY

This study uses a quantitative method with a population of 8 Islamic Commercial Banks and the sample was taken from 2011 to 2019 by calculating corporate governance variables using agency theory, macroeconomics with inflation indicators, and bank interest rates as well as Islamic bank financial stability variables calculated by NPF

### d. Locale and Sampling

Population of 8 Islamic Commercial Banks and the sample was taken from 2011 to 2019

## III. DISCUSSION

Table 1. Anova A

Model	Sum of Squares	df	Mean Square	F	Sig
1 Regression	429	2	215	572	593b
Residual	2.254	6	376		
Total	2.683	8			

### a. Dependant Variable : NPF

Predictors : (Constant), Makroekonomi, GCG

Based on the results of the F test above, it can be seen that the F value obtained is 0.572 with a significance value of 0.593. The significance value is greater than 0.05 which means that there is no influence of Corporate Governance and macroeconomics on the financial stability of Islamic banks as indicated by the NPF.

Table 2. Coefficients A

	Unstandardized		Standardized	t	Sig.
	Coefficients		Coefficients		
Model	B	Std. Error	Beta		
1 (Constant)	1.342	1.961		684	519
GCG	1.188	1.203	377-	988	361
	-073	123	-226	-	-
Makroekonomi				592	576

a. Dependant Variable : NPF

Based on the data above, the NPF is equal to 0.377 plus -0.226 meaning that the GCG variable has no effect on Financial Stability while Macroeconomics has a negative effect on financial stability.

The GCG t-test has no effect on Financial Stability because the t-count value is 0.988 with a significance of 0.361 greater than 0.05 as well as macroeconomics has a negative effect on financial stability because the t-count is -0.592 and the significance is 0.576 greater than 0.05.

## IV. CONCLUSION

The findings of this study the number of double jobs makes corporate governance in Islamic banks not affect the financial stability of Islamic banks while macroeconomics has a negative effect

### A. Implications

The use of online advertising is a good avenue for cellphone shops to attract and eventually encourage the consumers to buy smartphones. Online advertising is advantageous to business owners because it has an Islamic banks should improve governance to increase credit reduction and adjust lending to reduce negative effects on the macroeconomy.

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